

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
CANER AUTO, INC.	:	DECISION
	:	DTA NO. 822237
for Revision of a Determination or for Refund of	:	
Sales and Use Taxes under Articles 28 and 29 of	:	
the Tax Law for the Period March 1, 2003 through	:	
November 30, 2005.	:	

Petitioner filed an exception to the determination of the Administrative Law Judge issued on February 18, 2010. Petitioner appeared by Thomas P. Murray, CPA. The Division of Taxation appeared by Mark Volk, Esq. (Peter B. Ostwald, Esq., of counsel).

Petitioner filed a brief in support of its exception. The Division of Taxation filed a brief in opposition. Petitioner filed a reply brief.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether, in determining additional sales and use taxes due from petitioner, the Division of Taxation properly applied the results of a one-day observation test to the entire audit period.

II. Whether, in determining additional sales tax due on petitioner’s sales of gasoline, the Division of Taxation properly included petroleum business tax in the taxable base of gasoline sales subject to the imposition of sales tax.

III. Whether, in determining additional sales tax due on petitioner’s sales of cigarettes,

the Division of Taxation properly included New York State excise tax in the taxable base of cigarette sales subject to the imposition of sales tax.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

An audit of Caner Auto, Inc. (Caner) began in December 2005. Caner operated a convenience store and gas station in Bay Shore, New York. The convenience store sold cigarettes, beer, soda, candy and auto items; the gas station sold Getty gasoline and products and, for a portion of the audit period, operated three repair bays.

According to the audit report, an appointment letter was sent to Caner on December 12, 2005 and the auditor visited the business in January 2006.¹

On January 19, 2006, the Division of Taxation (Division) and Caner executed a Test Period Audit Method Election form wherein it was agreed that the audit of Caner's sales would be conducted using a test period method audit. The Test Period Audit Method Election form states thereon as follows:

Note: When my records are complete and available for the entire audit period, the Tax Department may not determine my tax based upon a test period audit without my consent. However, if I find that it may be practical to use the test period method audit, I may agree to use such a method by completing this form.

* * *

The Tax Department representative has explained to me the various audit methods listed above. If the auditor determines that my books and records are complete and adequate, I agree that the audit should be conducted using a test period

¹ The appointment letter and attached Records Requested List bear a date of July 19, 2006. However, the appointment letter indicates that the audit would begin on January 16, 2006 at the offices of Caner's representative.

method audit. It is understood that the agreement is contingent upon the adequacy of my records and pertains to the audit method to be used. It does not preclude my protest of the audit results on grounds such as

On January 20, 2006, the auditor made a written request for additional information, which included all invoices (soda, candy, etc.), information on auto sales, detailed information on all repairs (for the periods commencing in March 2005) and current fuel invoices for the period January 11 through January 20, 2006.

On January 26, 2006 and February 6, 2006, respectively, Caner and the Division executed a Consent Extending Period of Limitations for Assessment of Sales and Use Taxes Under Articles 28 and 29 of the Tax Law whereby it was agreed that the amount of sales and use taxes due from Caner for the period March 1, 2003 through November 30, 2005 would be assessed on or before April 30, 2007.

According to the Field Audit Narrative Sheet, dated December 11, 2006, the audit performed was described as follows:

An audit of sales and use tax was performed for the period 3/01/03 - 11/30/05. Daily cash register records from the store were not available but they did have daily hand written sales records. Cigarette prepaid was calculated from invoices and compared to the reported credit. Purchase invoices were listed for the test period. However not all invoices were not [sic] made available. Fuel invoices were listed and compared to reported sales. OPIS [Oil Pricing Information Service] was checked and compared to reported price per gallon. Repairs were listed from available invoices and compared to part purchases when possible. All purchase invoices were requested at the closing conference as well as information on auto sales and the repair business. No additional information was sent. Because records were inadequate an observation test was performed on September 13, 2006 from 6am - 10pm.

It must be noted that the Tax Field Audit Record states that on March 8, 2006, the auditor left a voice mail for Caner's representative "requesting status on additional information." On April 7, 2006, the auditor telephoned Caner's representative "requesting update on information

requested.” On May 4, 2006, “Information rec’d reviewed and completed assessment. Sent 30 day letter to POA.”

The auditor stated that he utilized the purchase invoices made available for the test period of March 1 through May 31, 2005, calculated a profit margin and marked up the purchase invoices by 25%.

Caner’s store purchases for the test period were \$35,149.00. By applying the 25% markup, store sales were determined to be \$43,936.00. An examination of Caner’s repair bay sales for the test period revealed that such sales totaled \$8,238.00. Therefore, total sales, excluding fuel sales, were found to be \$52,174.25. By applying the sales tax rate of 8.75%, sales tax per audit was \$4,565.25. After deducting Caner’s audited cigarette prepaid tax for the test quarter of \$2,494.00 ($\$2,206.00 \times 113.06\%^2$), sales tax due was determined to be \$2,071.25.

For the test quarter, Caner had reported total taxable sales of \$34,716.00. Applying the sales tax rate of 8.75% resulted in sales tax reported of \$3,037.65. After deducting Caner’s cigarette prepaid credit of \$2,206.00, sales tax reported for the quarter was \$831.65. Therefore, pursuant to this test period audit, additional sales tax of \$1,618.00 was due³. An error rate of 50.26% was calculated by the auditor, which was used throughout the audit period.

Applying the error rate of 50.26% to reported taxable sales for the audit period of \$415,637.00 with audited sales tax due thereon of \$54,624.00 and crediting Caner with audited prepaid cigarette tax of \$28,198.00 and tax reported of \$11,222.00, resulted in additional store

² The audit report indicates that Caner’s cigarette prepaid tax was underreported and, accordingly, additional credit was given.

³ It is unclear from where the auditor derived the additional sales tax due of \$1,618.00. Pursuant to Schedule B of the audit report, additional store tax of \$1,239.00 plus fuel tax of \$2,116.00, or total additional tax of \$3,355.00 was due from Caner for this test period.

tax of \$15,204.00. Additional fuel tax was determined to be \$16,653.00, for a total additional tax due of \$31,857.00 for the audit period.

As noted in the Tax Field Audit Record, on May 4, 2006, a Statement of Proposed Audit Change for Sales and Use Tax was sent to Caner, which asserted additional tax due in the amount of \$31,858.00, plus penalty and interest, for a total amount due of \$52,598.74 for the period March 1, 2003 through November 30, 2005.

The Tax Field Audit Record contains a notation that this case was closed on July 19, 2006, which coincidentally, was the date set forth on the appointment letter and records requested list (see Footnote 1).

After the Division issued the Statement of Proposed Audit Change for Sales and Use Tax on May 4, 2006, Caner's representative set forth in writing his disagreement therewith. In summary, Caner's representative's disagreement was as follows:

- a. Taxable gasoline sales were increased by including petroleum business tax (14 cents per gallon) while excluding New York State excise tax (8 cents per gallon) in the taxable base for computing sales tax. Taxable sales were also increased with no explanation, which Caner's representative assumed related to a comparison with OPIS;
- b. As to the additional tax asserted to be due on sales other than gasoline sales, Caner objected to the 25% markup on cigarette purchases, which Caner asserts was in contradiction to the actual pricing reflected in Caner's records; and
- c. Caner objected to including repair bay sales in the auditor's calculation for the quarter ended May 31, 2005 and applying the error rate to the entire audit period since Caner did not engage in repairs until the quarter ended May 31, 2005.

After receiving Caner's representative's written disagreement with the audit findings, the auditor's supervisor decided to perform an observation test of Caner's business operation. By letter to Caner's representative dated August 23, 2006, the auditor stated, in relevant part, as follows:

As you are aware, a sales tax audit of the above-referenced taxpayer is currently in progress. Per our discussions, the vendor's books and records are insufficient to determine if the proper amount of sales tax has been reported for the audit period.

This letter will confirm our recent conversation regarding the necessity to perform an observation at your place of business within the next six weeks. Sales activity will be recorded for an entire day, from opening to closing. The observation will be performed discreetly, with minimal interruption of business activity.

Kindly inform your client of this observation at your earliest convenience.

The Division performed its observation test at Caner's place of business on September 13, 2006 from 6:00 A.M. until 10:00 P.M. Gross sales for the day were \$550.80, of which \$493.61 were taxable sales. Taxable sales per pack of cigarettes were used as the basis of determining sales tax liability. During the observation test, Caner sold 49 packs of cigarettes. From these figures, the auditor determined that petitioner had taxable sales of \$10.07 per pack of cigarettes (\$493.61 divided by 49 packs).

For the six-month period from March 2005 through August 2005, Caner had reported prepaid cigarette tax in the amount of \$4,717.67 on 12,939 packs of cigarettes purchased. The auditor determined that Caner had prepaid cigarette tax in the amount of \$4,999.40 for the period, which indicated that 13,700 packs had been purchased. The result was an accepted prepaid percentage of 105.88%.

The auditor then determined that for the audit period (March 1, 2003 through November 30, 2005), Caner had reported total cigarettes purchased in the amount of 68,908. By

applying the aforesaid percentage of 105.88%, the auditor determined that Caner had purchased 72,960 packs of cigarettes during the audit period. He then multiplied the total number of packs (72,960) by the \$10.07 (taxable sales per pack of cigarettes) to arrive at audited taxable sales of \$734,975.00 for the period. The auditor then multiplied the audited taxable sales by the appropriate tax rate, which resulted in audited tax of \$64,044.00.

Caner had reported taxable sales of \$415,637.00 for the audit period and had reported tax in the amount of \$36,162.00 for the audit period. Based upon the prepaid percentage of 105.88%, audited prepaid tax of \$26,412.00 was computed. Caner had reported prepaid tax of \$24,941.00. To determine total store tax due, the auditor subtracted audited prepaid tax of \$26,412.00 from the audited tax of \$64,044.00, which result was \$37,632.00. He then subtracted reported prepaid tax of \$24,941.00 from reported tax of \$36,162.00, which result was \$11,221.00. By subtracting the reported tax of \$11,221.00 from audited tax of \$37,632.00, the resulting store tax was determined to be \$26,410.00. The auditor found that Caner had repair bay sales only for the period March 1, 2005 through November 30, 2005 totaling \$25,241.00, with tax due thereon of \$2,187.00 that, when added to store tax due, resulted in additional tax due of \$28,597.00.

After reviewing Caner's sales of gasoline and diesel, its prepaid fuel tax and its reported sales tax collected on sales of fuel (gasoline and diesel), the auditor determined that Caner owed additional sales tax on its sales of motor fuel of \$16,653.00. When this amount was added to the store tax and repair bay tax of \$28,597.00, the result was total additional tax due of \$45,251.00.

Accordingly, on October 18, 2006, the Division issued a Statement of Proposed Audit Change for Sales and Use Tax to Caner that asserted additional tax due of \$45,252.00, plus

penalty and interest, for a total amount due of \$78,424.99 for the audit period.

On November 12, 2006, Caner's representative again set forth in writing his disagreement with this latest Statement of Proposed Audit Change for Sales and Use Tax. Caner's representative noted that the auditor had failed to address his original objections to the May 4, 2006 Statement of Proposed Audit Change for Sales and Use Tax and, instead, had used the results of the observation test, which he noted, "asks the question are we to be exposed to a changing set of analysis until a level of assessment is reached and retaliates against the taxpayer but is acceptable to the management team?"

On January 2, 2007, the Division issued a Notice of Determination to Caner in the amount of \$45,252.00, plus interest, for a total amount due of \$62,007.26 for the period March 1, 2003 through November 30, 2005. It must be noted that despite the fact that penalty was asserted in the October 18, 2006 Statement of Proposed Audit Change for Sales and Use Tax, no penalty was assessed in the Notice of Determination.

Thereafter, Caner timely filed a request for a conciliation conference with the Division's Bureau of Conciliation and Mediation Services (BCMS) and a conciliation conference was held on November 7, 2007. On January 25, 2008, a Conciliation Order (CMS No. 218152) was issued by BCMS, which reduced the tax assessed against Caner from \$45,252.00 to \$24,364.00, plus interest at the applicable rate.

The conciliation conferee made no changes to the amount of fuel tax due (\$16,653.00), but reduced the store and repair bay tax due from \$28,597.00 to \$7,711.00. The amount of taxable sales per the observation test on September 13, 2006 (\$494.00) was multiplied by 91 days per quarter, which resulted in audited taxable sales of \$44,954.00 per quarter, or \$494,494.00 for

the eleven sales tax quarters of the audit period. Added to the \$494,494.00 was \$25,241.00, which amount represented repair bay sales for the last three quarters of the audit period (March 1, 2005 through November 30, 2005). Tax due thereon was computed to be \$45,343.00. Audited prepaid cigarette tax (\$26,411.00) and net tax reported (\$11,222.00) were subtracted from the \$45,343.00, thereby resulting in additional store (and repair bay) tax due of \$7,711.00. When added to the fuel tax due of \$16,653.00, total tax due was determined to be \$24,364.00.

On March 3, 2008, the Division issued a Notice and Demand for Payment of Tax Due in the amount of \$37,184.51, which consisted of tax due of \$24,364.00, plus interest.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge upheld the Notice of Determination issued on January 2, 2007, as modified by the Conciliation Order CMS No. 218152 dated January 25, 2008. The Administrative Law Judge rejected the argument that the use of the one-day observation test was inappropriate in the absence of full records and found that the one-day observation test was adequate, and that the auditor in the revised audit did not incorrectly include an assessment of sales taxes on periods when the repair bay was not in use. Citing relevant sections of the Tax Law, the Administrative Law Judge determined that it was proper to include the tobacco business tax in the price of cigarettes subject to sales tax and the petroleum business tax in the price of gasoline subject to sales tax.

ARGUMENTS ON EXCEPTION

Petitioner reiterates its objection to the allowance of the use of a one-day observation test on cigarette sales in the absence only of cash register tapes. Further, petitioner objects to the imposition of tax on the ground that the statute permits a tax on a tax imposed by the same taxing

authority. Petitioner states that the Administrative Law Judge's determination was unreasonable, in that it allows the Division to change its method when challenged with documentary evidence, rather than justify and prove its position even in the face of the major repudiation of the Conciliation Order.

OPINION

We affirm the determination of the Administrative Law Judge.

We reject petitioner's arguments, which take issue with the audit methodology employed by the Division. Tax Law § 1138(a)(1) provides, in relevant part, that if a sales tax return was not filed, "or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined [by the Division] from such information as may be available." It is well-settled that such audit methodologies may employ external indicies (*Matter of Urban Liqs. v. State Tax Commn.*, 90 AD2d 576 [1982]). When acting pursuant to section 1138(a)(1), the Division is required to select a method of audit reasonably calculated to reflect the tax due (*Matter of Bernstein-On-Essex St.*, Tax Appeals Tribunal, December 3, 1992). The burden then rests upon the taxpayer to demonstrate that the method of audit or the amount of the assessment was erroneous (*see Matter of Your Own Choice*, Tax Appeals Tribunal, February 20, 2003).

This Tribunal has often stated the standard for reviewing a sales tax audit where external indices were employed. As we set forth in *Matter of Your Own Choice* (*supra*):

To determine the adequacy of a taxpayer's records, the Division must first request (*Matter of Christ Cella, Inc. v. State Tax Commn., supra*) and thoroughly examine (*Matter of King Crab Rest. v. Chu*, 134 AD2d 51, 522 NYS2d 978) the taxpayer's books and records for the entire period of the proposed assessment (*Matter of Adamides v. Chu*, 134 AD2d 776, 521 NYS2d 826, *lv denied* 71 NY2d 806, 530 NYS2d 109). The purpose of the examination is to determine, through verification drawn independently from within these records (*Matter of Giordano v. State Tax Commn.*, 145 AD2d 726, 535 NYS2d 255; *Matter of*

Urban Liqs. v. State Tax Commn., 90 AD2d 576, 456 NYS2d 138; *Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; see also, *Matter of Hennekens v. State Tax Commn.*, 114 AD2d 599, 494 NYS2d 208), that they are, in fact, so insufficient that it is “virtually impossible [for the Division of Taxation] to verify taxable sales receipts and conduct a complete audit” (*Matter of Chartair, Inc. v. State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43; *Matter of Christ Cella, Inc. v. State Tax Commn.*, *supra*), “from which the exact amount of tax due can be determined” (*Matter of Mohawk Airlines v. Tully*, 75 AD2d 249, 429 NYS2d 759, 760).

Where the Division follows this procedure, thereby demonstrating that the records are incomplete or inaccurate, the Division may resort to external indices to estimate tax (*Matter of Urban Liqs. v. State Tax Commn.*, *supra*). The estimate methodology utilized must be reasonably calculated to reflect taxes due (*Matter of W.T. Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869, 2 L Ed 2d 75), but exactness in the outcome of the audit method is not required (*Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454; *Matter of Cinelli*, Tax Appeals Tribunal, September 14, 1989). The taxpayer bears the burden of proving with clear and convincing evidence that the assessment is erroneous (*Matter of Scarpulla v. State Tax Commn.*, 120 AD2d 842, 502 NYS2d 113) or that the audit methodology is unreasonable (*Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451; *Matter of Cousins Serv. Station*, Tax Appeals Tribunal, August 11, 1988). In addition, “[c]onsiderable latitude is given an auditor’s method of estimating sales under such circumstances as exist in [each] case” (*Matter of Grecian Sq. v. Tax Commn.*, 119 AD2d 948, 501 NYS2d 219, 221).

We reject petitioner’s contention that the assessment should be cancelled because it is based upon a one-day observation test. The use of a one-day observation test to determine gross and taxable sales for an audit period, where a taxpayer has failed to maintain adequate source documentation of sales, is supported by a large body of case law (*see Matter of Lombard v. Commissioner of Taxation & Fin.*, 197 AD2d 799 [1993] [upholding audit results based on a one-day observation test]; *Matter of Club Marakesh v. State Tax Commn.*, 151 AD2d 908 [1989], *lv denied* 74 NY2d 616 [1989]). It is well-settled that it is not unreasonable to extrapolate the results of a one-day observation test over the entire audit period (*Matter of Del’s*

Mini Deli v. Commissioner of Taxation and Fin., 205 AD2d 989 [1994]).

We also find no evidence supporting petitioner's contention that the audit was miscalculated. Specifically, petitioner objects to the utilization of the results of the observation test because it contends that such results were skewed because repair bay sales did not begin until the ninth quarter (i.e. March 2005 through May 2005) of the audit period. A review of the revised assessment reveals that repair bay sales totaling \$25,241.00, which represented sales only from March through November 2005, were included by the conciliation conferee in calculating the revised assessment and were not part of the \$493.61 taxable store sales per day calculation. Accordingly, we reject this argument.

We find no merit in petitioner's argument that the assessment should be cancelled because it is a tax on a tax. Petitioner contends that it should not have to pay sales tax on its fuel sales because the taxable base for petroleum sales includes the petroleum business tax. However, such inclusion is in accordance with the statute. Tax Law § 1111(k) provides as follows:

Receipts subject to tax under subdivision (a) of section eleven hundred five of this article on retail sales of motor fuel, diesel motor fuel and residual petroleum product, and consideration given or contracted to be given for motor fuel, diesel motor fuel and residual petroleum product, the uses of which are subject to tax under section eleven hundred ten of this article, shall be deemed to include any tax imposed on or with respect to motor fuel, diesel motor fuel or residual petroleum product under article thirteen-A of this chapter [Tax on Petroleum Businesses].

Further, in *Matter of A&A Service Station* (Tax Appeals Tribunal, February 5, 2004), this Tribunal affirmed an Administrative Law Judge's determination and stated that "[P]etitioner's argument that the auditor incorrectly calculated sales and use tax due on a tax base which included petroleum business tax" is without merit. The Tribunal noted that, "[P]ursuant to Tax Law § 1111(k), petroleum business tax is required to be included in the calculation of '[r]eceipts

subject to tax.”

With regard to petitioner’s objection to the inclusion of the cigarette tax in the price subject to tax, such inclusion is also provided by statute. Tax Law § 1111(h) provides, in relevant part, as follows:

Receipts subject to tax under subdivision (a) of section eleven hundred five on retail sales of cigarettes and tobacco products and consideration given or contracted to be given for cigarettes and tobacco products the uses of which are subject to tax under section eleven hundred ten shall be deemed to include any tax imposed on cigarettes and tobacco products by article twenty of this chapter [New York State tax on cigarettes and tobacco products] and any tax imposed on cigarettes by chapter thirteen of title eleven of the administrative code of the city of New York [New York City cigarette tax].

We find, as determined by the Administrative Law Judge, that it is unclear whether petitioner’s objection is based on constitutionality or questionable policy. However, in our view, the statutory language is clear and we need only apply the plain meaning of the language (*Patrolmen’s Benevolent Assn. v. City of New York*, 41 NY2d 205 [1976]). We further note that, if construed as a constitutional argument, this forum lacks the jurisdiction to consider whether a statute is unconstitutional on its face (*Matter of RAF General Partnership*, Tax Appeals Tribunal, November 9, 1995; *see also Matter of Lunding*, Tax Appeals Tribunal, February 23, 1995, **annulled on other grounds** 218 AD2d 268 [1996], **revd** 89 NY2d 283 [1996], **revd** 522 US 287 [1998]).

We have considered the remaining arguments and find them either without merit or not requiring a different result. The Administrative Law Judge properly addressed all of the remaining issues in the determination below.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Caner Auto, Inc., is denied;

2. The determination of the Administrative Law Judge is affirmed;
3. The petition of Caner Auto, Inc., is denied; and
4. The Notice of Determination dated January 2, 2007, as modified by the Conciliation

Order dated January 25, 2008, is sustained.

DATED: Troy, New York
September 8, 2011

/s/ James H. Tully, Jr.
James H. Tully, Jr.
President

/s/ Charles H. Nesbitt
Charles H. Nesbitt
Commissioner